



King County

Finance and Business Operations Division
Department of Executive Services

821 Second Ave.
Seattle, WA 98104-1598

June 29, 2007

**Honorable County Executive, Members of the
Metropolitan King County Council, and King
County Residents**

We are pleased to transmit to you the Comprehensive Annual Financial Report (CAFR) of King County, Washington (the County), for the fiscal year ended December 31, 2006. The governmental financial reporting model provides a picture of the County as a single, unified entity, while continuing to provide traditional fund-based financial statements. Each perspective (government-wide and major fund) allows the reader to address relevant questions, provides a basis for comparison, and enhances the County's accountability.

The report is presented in three sections: Introductory, Financial, and Statistical. The Introductory Section includes this letter of transmittal. The Financial Section, beginning with the independent auditor's report, contains management's discussion and analysis (MD&A), government-wide financial statements, fund and component unit financial statements, notes to the financial statements, required supplementary information, combining financial statements, and schedules. The Statistical Section includes selected financial trends, revenue capacity, debt capacity, demographic and economic data, and operating information. This letter of transmittal is designed to complement the MD&A, which presents a narrative introduction, overview, and analysis of the financial statements.

The CAFR consists of management's representations concerning the finances of the County. Consequently, management assumes full responsibility for the completeness and reliability of all information presented in this report. To provide a reasonable basis for making these representations, management has established a comprehensive internal control framework designed to protect the government's assets from loss, theft, or misuse, and to compile sufficient reliable information for the preparation of the County's financial statements in conformity with Generally Accepted Accounting Principles (GAAP). Because the cost of internal controls should not outweigh their benefits, the County's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatements. As management, we assert that, to the best of our knowledge and belief, the CAFR is complete and reliable in all material respects.

The County's financial statements have been audited by the Washington State Auditor's Office. The goal of the independent audit was to provide reasonable assurance that the basic

financial statements of the County for the fiscal year ended December 31, 2006, are free of material misstatements. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the County's financial statements for the fiscal year ended December 31, 2006, are fairly presented in conformity with GAAP. The auditor's report is presented as the first component of the financial section of this report.

The independent audit of the financial statements of the County was part of a broader, federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports will be available in the County's separately issued 2006 Single Audit Report, due September 30 (available online at <http://www.sao.wa.gov>).

Profile of the County

The County ranks number one in population in the State of Washington and is the financial, economic, and industrial center of the Pacific Northwest Region. Located between the sparkling blue waters of Puget Sound and the snowcapped Cascade Mountains, the County consists of 2,131 square miles, ranking 11th in geographical size among Washington state's 39 counties. As of December 31, 2006, the County contained 39 incorporated cities, which accounted for approximately 80 percent of its population.

King County operates under a Home Rule Charter adopted by a vote of the citizens of King County in 1968 and is organized under the Executive-Council form of county government. The Metropolitan King County Council is the policy-determining legislative body of the County. The Council's nine members are elected by district to four-year staggered terms and serve on a full-time basis. The County Council sets tax levies, makes appropriations, and adopts and approves the annual operating and capital budgets for the County. Other elected County officials include the County Executive, Prosecuting Attorney, Sheriff, Assessor, and Superior and District Court Judges. All are partisan positions, elected to four-year terms, except for the Sheriff and Judges, which are nonpartisan positions.

The County Executive serves as the chief executive officer of the County. The County Executive presents to the County Council annual statements of the County's financial and governmental affairs, the proposed budget, and capital improvement plans. The County Executive signs, or authorizes the signing of, all deeds, contracts, and other instruments on behalf of the County, and appoints the director of each executive department.

King County provides some services on a countywide basis and other services only to unincorporated areas. Within appropriate jurisdictions, the County provides public transportation, road construction and maintenance, wastewater treatment, flood control, agricultural services, parks and recreation facilities, law enforcement, criminal detention, rehabilitative services, court services, tax assessments and collections, land use planning and

permitting, zoning, public healthcare, emergency medical services, election services, animal control, and the disposal of solid waste. In addition, the County has contracts with some cities to provide services to incorporated areas within the County.

The reporting entity "King County" includes four component units: (1) the Harborview Medical Center (HMC); (2) the Washington State Major League Baseball Stadium Public Facilities District (PFD); (3) the Cultural Development Authority of King County (CDA, dba 4Culture); and (4) the Flood Control Zone Districts. The Harborview Medical Center, with a history dating back to 1877, is a comprehensive 413-bed healthcare facility operated since 1967 by the University of Washington under a management contract. The general conditions of the management contract specify that King County retains title to all real and personal property acquired with HMC capital or operating funds. The PFD is responsible for overseeing the maintenance and operation of Safeco Field, the Seattle Mariners' baseball stadium. The CDA was created in 2003 to support the arts, heritage, historic preservation, and public art throughout the County. The Flood Control Zone Districts account for the development, operation and maintenance of flood control or storm water control projects that benefit specific areas of the County.

Most funds in this report pertain to the entity King County Government. Certain Agency Funds pertain to the County's custodianship of assets belonging to independent governments and special districts. Under state statute and the County's Home Rule Charter, the King County Executive is the *ex officio* treasurer of all special purpose districts in King County, but not of cities and towns or the Port of Seattle. As provided by County ordinance, the Director of the Finance and Business Operations Division is responsible for the duties of the comptroller and treasurer. Money received from or for the special purpose districts is deposited in a central bank account. The Director of the Finance and Business Operations Division disburses money according to state and local regulations and invests cash balances based on standard agreements with the respective special purpose district's governing body or administrative officer.

Factors Affecting Financial Condition

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the County operates.

Local economy

Economic conditions have a direct impact on the County's revenues and the demand for County services. The County's revenue sources include taxes, charges for services, and intergovernmental revenues. The largest single source is taxes, which comprise approximately forty percent of total revenue, and consist primarily of taxes on real property and retail sales and use taxes. Property taxes tend to be quite stable since levy rates are calculated months in advance and King County establishes assessed value from four prior years of real estate sales. Other tax sources, such as the retail sales tax, are much more volatile and directly influenced by economic conditions in the region.

The 2001 recession had an adverse effect on regional employment and income growth. Economic conditions stabilized in 2003, before the current expansion started in 2004 –

evidenced by the first increases in total regional employment in four years. Rapid construction sector growth has led to job growth throughout the expansion, with reduced momentum in the past year. Renewed strength in manufacturing employment, fueled by the cyclical ramp up in aircraft manufacturing has surmounted job losses from the 2001 recession. Personal income in the County has also rebounded, with an average annual increase of 4.7 percent between 2003 and 2005, versus average growth of 0.4 percent from 2000 to 2002.

County taxable retail sales were hard hit by the recession. General Fund collections declined in 2001 for the first time since the State of Washington instituted the local option sales tax in 1971. Between 2000 and 2003, General Fund sales tax receipts fell by an unprecedented 7.17 percent. Strong growth in 2004 of 6.19 percent, in 2005 of 7.45 percent, and in 2006 of 6.85 percent has marked the sharp turnaround from the 0.72 percent decline in 2003.

Property assessment growth continues to accelerate, up 10.5 percent in 2006, compared with 8.5 percent, 5.6 percent, and 4.8 percent growth in 2005, 2004, and 2003, respectively. Assessed value is appreciating slower than the meteoric growth experienced at the start of the decade – 12.1 percent in 2001 and 13.4 percent in 2000 – but clearly reflects strong market conditions. The ailing commercial market has regained strength just in time to offset a forecasted, but as yet unseen, decline in the demand for residential property.

County general fund property tax collections increased by 2.5 percent in 2006, compared with 0.8 percent growth in 2005, 3.6 percent growth in 2004, and 2.8 percent growth in 2003. All of these are still below the 4.5 percent growth in 2002, 4.6 percent growth in 2001, and 6.6 percent growth in 2000, the year before passage of Initiative 747. Current year property tax delinquencies set a record low of 1.89 percent in 2006, continuing a general downward trend. Delinquencies were 2.56 percent, 2.22 percent, and 2.25 percent in 2003, 2004, and 2005, respectively.

Economic outlook

For 2007, mixed national conditions are not expected to diminish the strong local economy. Total regional employment growth in 2007 is forecast to outpace population growth by 3.6 percent to 1.5 percent, building on the strong performance in 2006 – 4.4 percent to 1.5 percent. Strong personal income growth is also anticipated while manufacturing, in particular, benefits from the weak dollar.

King County will continue to face numerous challenges, including volatile energy prices, rising employee and programmatic health care costs, and the need to raise sufficient revenues to support utility, transit system, and general government operations.

Long-term financial planning

For the first time since 1998, in the fall of 2005 the county transmitted a balanced three-year general fund financial plan that achieved a small surplus in each year without requiring service reductions. Attributable to aggressive financial planning and management, the structural deficit that has plagued county finances since the late 1990s appears to have been tamed by lower cost growth. The budget office continues to project cyclical deficits – that is, a downturn in regional economic conditions can be expected to result in the return of general fund

deficits. However, with steady growth forecast over the next year, no deficit is anticipated in 2008.

The slow process of transitioning unincorporated areas to cities through annexation and incorporation continues. While efforts in East Renton were dealt a blow by voter rejection of annexation, each of the ten major potential annexation areas now has a potential annexing city with declared interest. This breakthrough was spurred in no small measure by the state sales tax credit enacted last year by the Washington State Legislature. With a 2010 deadline approaching under the legislation, several interlocal agreements are expected in 2007, with a significant portion of urban unincorporated areas transitioning to cities in 2008.

The legislature also recently enacted streamlined sales tax sourcing legislation. This act, which conforms Washington's sales tax code with national standards, takes effect in mid-2008. The impact on countywide collections is slightly negative, but is offset with state mitigation payments. However, most unincorporated areas will see a boost in sales tax receipts of 10-12 percent.

King County still faces substantial difficulties in balancing limited revenues (largely stemming from Initiative 747's tight constraints on property tax revenue) with the ever-growing demand for services. Property tax growth remains capped at approximately 3 percent annually over the coming years (1 percent plus the value of new construction). While costs since 2003 have been held well under historic growth rates of 5 to 6 percent, it will clearly be a challenge to continue to rein in expenditures in the face of labor cost drivers and service utilization levels.

The County reaffirms its steadfast commitment to maintain a 6 percent undesignated reserve policy and also its willingness to make often painful decisions in order to reduce expenditures to match revenue levels while retaining prudent reserves. At the state level, the County also continues to pursue statutory enhancements to local government revenues to more flexibly balance revenues with long-term cost pressures.

Major Initiatives in 2006

Transit Now

In November 2006, the voters of King County approved King County Proposition 2, Transit Now. The one-tenth of one-percent increase in the King County sales tax that resulted from this vote will provide the Public Transportation Enterprise with the resources to increase transit service by an estimated 15 to 20 percent systemwide over the next ten years. It is a critical element in accommodating the region's continued population and employment growth. The program is intended to get 50,000 to 60,000 drivers off the road and into buses each weekday to keep regional congestion in check. It will also provide traffic relief to commuters affected by construction of highways and other transportation projects.

The sales tax increase went into effect on April 1, 2007. The Public Transportation Enterprise will receive the first proceeds from the increase in June, 2007. Based on initial estimates, the annual impact of the increased sales tax is \$50 million in 2008 growing to over \$70 million by 2016.

Transit Now has four key elements:

- **RapidRide:** Bus Rapid Transit (BRT) is a term used to describe transit services and facility improvements that achieve faster operations than traditional buses. Under this element of Transit Now, the Public Transportation Enterprise will purchase new buses, upgrade passenger waiting areas, add technology to synchronize traffic signals and operate real-time bus arrival signs, along five selected corridors:
 - Aurora Avenue N. between Shoreline and downtown Seattle
 - Ballard to downtown Seattle along 15th Avenue N.W. and W. Mercer Place
 - West Seattle to downtown Seattle with a possible extension to the University District using the downtown transit tunnel and Interstate 5
 - Bellevue to Redmond on N.E. Eighth Street and 156th Avenue N.E. via Crossroads and Overlake
 - SeaTac to Federal Way on Pacific Highway S.
- **More Service:** Transit Now will provide for more all-day, two-way core bus services that connect residential, business and recreational centers throughout the county.
- **New Service for Growing Areas:** Transit Now will allow the Public Transportation Enterprise to increase service to growing residential areas in suburban King County by adding peak service in areas not currently served, and offering midday service in some areas that currently only have peak service.
- **Service Partnerships:** Transit Now sets aside resources for partnerships with major employers and cities, potentially leveraging millions in additional funding from other sources to add new service in rapidly expanding employment centers.

Transit Now will also expand Access paratransit service; make ridership improvements to double the participation in Vanpool and VanShare programs; develop a network of all-day, 15-minute-service routes connecting most business and residential centers within the central Eastside area; create routes to connect Crossroads, Overlake, Kirkland, Redmond, Bellevue, Bellevue Community College, Eastgate, and Factoria; improve east-west connections in Seattle; increase frequency between Northgate, the University District, and downtown Seattle; and revise existing routes to better connect with Link light rail at the Othello Station in southeast Seattle. The Public Transportation Enterprise will begin implementing the initial elements of Transit Now in 2007.

King County Executive Action Group on Global Warming

The King County Executive Action Group on Global Warming is an interdepartmental team of 15 county employees who meet biweekly under the leadership of Executive Sims' Deputy Chief of Staff, to develop additional knowledge, collaborative strategies and shared resources on global warming action in our region. The group was convened in January 2006, after the King County Climate Conference of October 2005 sparked countywide enthusiasm for reducing greenhouse gas emissions and preparing for regional effects of global warming.

King County has the authority – in land use planning, public transportation provision, environmental management and clean energy investment – to take actions necessary to combat climate change in our region. When built strategically into a climate change action

plan, such as the 2007 King County Climate Plan, King County's numerous operational responsibilities, planning authorities, regulatory powers and opportunities for investment can influence and motivate both climate change emissions reduction and climate change adaptation.

While greenhouse gas emissions produced within the King County region constitute only a small percentage of national and global quantities, our region can play a critical role in pioneering the policies, practices, and investments that inform climate change mitigation efforts worldwide. In addition, King County and its partners are already implementing and refining practical preparedness steps so that King County can provide leadership for governments worldwide to adapt to the inevitable changes that will take place.

Since its initial meetings in January 2006, the Executive Action Group has been charged with reviewing every policy, plan and infrastructure investment in light of global warming emissions and impacts. This team's work resulted in the following:

- Development of an "Acting Locally" initiative for global warming preparedness in March 2006;
- Formation of a partnership with the Climate Impacts Group to write a guidebook for regional governments on how to adapt to climate change impacts, which will be published in 2007 by the ICLEI (International Council for Local Environmental Initiatives) – Local Governments for Sustainability;
- Development of a mitigation "toolkit" for other regional governments, based on its experience investing in and using hybrid vehicles and buses, biofuels, waste-to-energy innovations, water reclamation and green building as elements of a comprehensive strategy to reduce operational greenhouse gas emissions;
- Entrance into the Chicago Climate Exchange (CCX), a voluntary market in which members commit to reduce greenhouse gas emissions and earn financial reward for "green" initiatives;
- Collaboration with the King County Council to develop the motion resulting in Ordinance 12362, ensuring that climate change will be incorporated into King County's programs and functional activities;
- Launch of an Urban Leaders Initiative with the Center for Clean Air Policy in Washington, D.C., to exchange lessons about dealing with global warming emissions and impacts among leaders of large urban regional governments; and
- Hiring of a Global Warming Coordinator in January 2007 to manage the production of the King County Climate Plan and related activities.

Most recently, as a result of the Executive Action Group's work, the 2007 King County Climate Plan called for an 80 percent reduction of greenhouse gas emissions below current levels by 2050, and for implementation of strategies to make the County government and region more resilient to projected consequences of climate change in our region. The Climate Plan is one illustration among many that the work of the King County Executive Action Group on Global Warming is optimistic, forward looking and ambitious about King County's role in fighting global warming.

Children's Health Initiative

In April 2006, King County Executive Sims convened a Children's Health Access Task Force of child health experts to advise King County on the creation of an innovative County-based children's health program. Dr. Maxine Hayes, the Washington State Health Officer, and Dr. Ben Danielson, the Medical Director at Odessa Brown Children's Clinic, co-chaired the Task Force, with support from Milliman consultants and actuaries who carried out actuarial and programmatic analyses of various program designs. The Task Force recommended the creation of a program that will dovetail with the State's 2010 goal and build on the innovative work of the King County Health Action Plan, such as the Kids Get Care program.

King County Sheriff's Office Blue Ribbon Panel

In 2006, the Sheriff's Office convened a Blue Ribbon Panel of law enforcement experts to review management practices related to police misconduct and discipline. The Panel released its final report in September. While the report found no evidence of corruption, excessive use of force, systemic racial profiling, or widespread disciplinary problems, it did identify a number of areas for improvement within the Sheriff's Office. The Panel's report contained nine priority recommendations including reducing supervisor's span of control, creating internal and external oversight functions, increasing training, establishing an employee early intervention system, improving labor relations, and conducting a cultural audit. Funding for several of these recommendations are included in the 2007 Adopted Budget.

Cash Management Policies and Practices

King County managed a \$3.5 billion (annual average) investment pool (the Pool) during 2006 and distributed \$165.6 million in interest earnings to a combination of County agencies and 99 other special districts and public authorities participating in the Pool. In accordance with RCW 36.48.070, the County's Executive Finance Committee reviews the Pool's investment practices and policies on a regular basis. The Pool seeks to obtain a market rate of return while preserving and protecting capital. The Pool pursues its objectives by investing in high quality securities, including US Treasuries, US Agency notes and mortgage-backed securities, taxable municipal notes, commercial paper, certificates of deposit, repurchase agreements, and the State of Washington's Local Government Investment Pool. The Standard & Poor's Rating Services has assigned its 'AAAf' credit quality rating (highest level of protection) and 'S1' volatility rating (lowest volatility) to the Pool. The rating indicates an extremely strong level of protection against losses from credit defaults.

All County money is invested in the Pool. During 2006 the Pool realized an average yield of 4.7 percent, up from 3.2 percent in 2005. Interest earnings of County funds in 2006 were over \$71 million, including over \$22 million for the General Fund.

Risk Management

As a municipal organization, the County has a wide range of loss exposures. The County uses three internal service funds to account for and finance property/casualty, workers' compensation, and employee medical and dental benefits self-insurance programs. Note 10 –

Risk Management discloses the specific programs and claims liability changes during 2006 for each insurance program.

Pension Benefits

Qualifying County employees participate in the Public Employees' Retirement System (PERS), the Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF), the Public Safety Employees' Retirement System (PSERS), or the Seattle City Employees' Retirement System (SCERS). PERS, LEOFF, and PSERS are statewide local government retirement systems administered by the State of Washington's Department of Retirement Systems under cost-sharing, multiple-employer defined benefit and defined contribution public employee retirement systems. Note 8 – Pension Plans presents plan descriptions and information on funding policies.

Awards and Acknowledgements

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to King County for its comprehensive annual financial report for the fiscal year ended December 31, 2005. This was the 25th consecutive year that the County has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of this report would not have been possible without the efficient and dedicated services of the Financial Accounting staff of the Finance and Business Operations Division. We would like to express our appreciation to all members of the division who assisted and contributed to the preparation of this report. Credit must also be given to the Executive and County Council for their support for maintaining the highest standards of professionalism in the management of the County's finances.

Respectfully submitted,



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Pete Anthony, CPA
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